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AGRICULTURAL CREDIT LEGISLATION AND THE TENANCY PROBLEM

That the American states are vigorously attacking the agricultural credit problem is evidenced by the number of rural credit measures which have been enacted into law within the last two years.¹ No less than seven states now have comprehensive laws

¹The history of state rural credit measures may be sketched briefly as follows:

Massachusetts passed a law on credit unions in 1909; Texas on rural credit unions in 1913; Wisconsin on coöperative credit associations in 1913; and New York on credit unions in 1914. In 1913 a law was passed in Wisconsin providing for the incorporation and regulation of land-mortgage associations. The associations were authorized to make long-term loans to farmers on first mortgage security and to issue and sell mortgage bonds. In the following year the New York legislature provided for the organization of the land bank, a central institution, with the power to issue bonds on the security of farm mortgages turned over to it by local savings and loan associations.

During the current legislative year laws providing for the organization of credit unions or coöperative banks have been passed in Massachusetts, North Carolina, Oregon, and Utah. Massachusetts and Utah, following the example set by Wisconsin, enacted special laws for the organization of farm land banks. Similar measures were defeated in California, Indiana, Iowa, Michigan, and Nebraska. In Kansas and North Carolina the laws on building and loan associations were amended to enable those institutions to make long-term loans on agricultural lands. The California legislature authorized the governor to appoint a commission to investigate rural credit schemes at home and abroad.

In some states there has been a disposition to regard the land credit problem of such serious nature as to warrant the adoption of a policy of state aid. For a number of years Idaho, Indiana, Iowa, North Dakota, Oklahoma, Oregon, South Dakota, and Utah have been investing certain permanent school funds in farm mortgages. In 1913 Wisconsin adopted a similar policy, authorizing that the state's school fund be loaned to farmers for the purpose of making permanent farm improvements. Another law of the same year provided for the issuance of bonds by counties to enable farmers to clear their lands for agricultural purposes. So far, nothing has been accomplished by either law (Wisconsin Bulletin 247, Jan., 1915, p. 31). In the early part of the present year (1915) the legislature of Wyoming authorized the state treasurer to invest, subject to certain conditions, the funds arising from the sale of state lands in irrigation bonds. A bill providing for the investment of the state's permanent funds in farm mortgages at not less than 6 nor more than 7 per cent failed to pass. The North Dakota legislature proposed an amendment to the state constitution which, if adopted, will enable the state to establish a loan fund and pledge its credit either to individual farmers or to rural credit associations. In Montana, authority has been given to the state treasurer to issue bonds and make long-term loans to farmers on the security of first mortgages whenever the demand

designed to bring about desirable reforms in the land credit system. In seven states there have been enacted laws governing the formation and management of credit unions or coöperative credit associations. The most important legislative measures, however, have been concerned with the problem of land credit reform. Massachusetts, Utah, and Wisconsin have made special provision for the establishment of competitive farm land banks under state supervision; the New York legislature has provided for the organization of the Land Bank of the State of New York, a central institution, to be owned and controlled by local savings and loan associations; while Missouri, Montana, and Oklahoma have abandoned all hope of solving the rural credit problem through private initiative and have adopted modified programs of state loans.

These measures are not altogether dissimilar. Although there is considerable difference in the proposed machinery for administration and supervision, all contain plans looking toward a longer term of loans, repayable by amortization, and the issuance of bonds on the collective security of farm mortgages. The chief differences are to be found in the effect which these measures are expected to have upon the farmer's rate of interest. From this point of view the laws are of two fairly distinct types. One type seeks merely to reduce a portion of the waste in the present land credit system by improving the method of making loans and by giving greater mobility to funds seeking safe investment. The other contemplates, in addition, a material reduction in the farmer's rate of interest either through the organization of a strong central bank or through a program of minimum state aid.

The laws of Missouri, Montana, New York, and Oklahoma are examples of the latter type of legislation. If they succeed in accomplishing the definite purpose for which they were enacted, the farmer's rate of interest on long-term loans will be about 6 per cent² in Montana and Oklahoma, and 5 per cent or less in Mis-

for bonds is equal to the demand for farm loans. Applications and subscriptions are to be received by the county treasurers. To insure prompt payment of interest on the bonds a guarantee fund has been provided by the state. Finally, Missouri and Oklahoma have provided for the appropriation of certain state funds to be used as initial working capital for a system of long-term loans. Additional funds will be obtained through the sale of bonds secured by first mortgages or deeds of trust.

²The Montana law (Laws of Montana, 1915, ch. 28) provides that the state treasurer may issue 5 per cent bonds, secured by farm mortgages, whenever applications for loans and subscriptions to bonds are sufficient to warrant a series of \$100,000. Smaller bond issues may be made from time

souri and New York. These rates are well below the rate that is current in the respective states.

The Missouri law³ is the most drastic of these measures. Briefly, it provides for the establishment of a Missouri land bank, annexed to the office of the state bank commissioner, under the direction and supervision of a board of governors composed of the governor of the state, the attorney general, the secretary of state, the state treasurer and the state auditor. Loans varying from \$250 to \$10,000 are to be made to farmers up to 50 per cent of the value of their lands for terms of not less than five nor more than twenty-five years. An amortization scheme, borrowed with some inaccuracies from the *Crédit Foncier*, provides for the repay-

to time at a rate of interest agreed upon by all the applicants for loans. Loans will be amortized by semi-annual payments equal to 4 per cent of the face value of the mortgages. One eighth of each payment or less, in the discretion of the state treasurer, will be used to pay the expenses of administration. The inference is that the farmer's rate of interest will be 6 per cent or less when bonds are issued in series of \$100,000.

The law authorizes the appropriation of \$20,000 from the state treasury to be used as a guarantee fund. In the event of default by a mortgagor, the state treasurer will draw upon this fund to satisfy the holders of bonds, but the amount thus drawn must be restored to the fund either from the proceeds of foreclosure sale or by a direct levy on all mortgagors benefiting under the same bond issue. The effect of this guarantee on the investment character of the bonds seems to be of doubtful value when it is reflected that the mortgages rather than the bonds are to be exempt from taxation.

The Oklahoma law (Laws of Oklahoma, 1915, chs. 34, 284) provides that the commissioners of the land office may make loans to farmers at 6 per cent, for terms of 23½ years. In order to provide sufficient funds for this purpose, the commissioners are authorized to issue 5 per cent bonds on the security of certain state educational lands. Further issues, bearing the same rate of interest, may be made on the security of the mortgages held by the commissioners. This would seem to create an almost inexhaustible fund provided no difficulty is experienced in floating the bonds. Although not guaranteed by the state, the bonds will bear the signatures of the governor, the president of the state board of agriculture, and the state auditor, and will be approved security for the deposit of public funds and legal investments for trust funds. The income from the bonds will be subject to the income tax.

³Laws of Missouri, 1915, H. B. 877, p. 196. The law will not become operative until December 1, 1916. There was some doubt at the time the measure was proposed as to whether it would be constitutional for the legislature to appropriate \$1,000,000 from the state treasury for the purpose of organizing the bank. To avoid all possible constitutional difficulties it was deemed best to postpone the organization of the bank until the law could be submitted to the voters of the state under the "initiative."

ment of the principal within the term of the loan in fixed annual payments consisting of interest, one half per cent on account of the reserve, and the remainder on account of principal. The law expressly stipulates that loans are to be made only for the ordinary productive purposes, *i.e.*, to complete the purchase price of land, to pay off existing encumbrances, and to make permanent improvements. Of the total amount loaned, 25 per cent may be used for the purchase of stock and machinery.

The initial working capital of the bank, \$1,000,000, is to be appropriated by the legislature from the funds in the state treasury. One half of this amount will be loaned to applicants at a net interest rate of 4.3 per cent. Thereafter, capital will be provided through the sale of debenture bonds, issued in series of \$500,000, and loaned to farmers at the rate which the bank must pay on the bonds. Whenever there are deeds of trust on hand aggregating \$500,000, a new series of bonds will be issued until the total issue has reached \$40,000,000. Further issues may be made indefinitely at a ratio of \$30 of bonds to \$1 of the reserve.

An effort is made to give the bonds a high standing as investment securities. Every series of bonds will be secured by a like amount of deeds of trust on farm lands within the state appraised at double the face value of the bonds. For the purpose of insuring careful appraisement, the state is to be divided into districts and an expert appraiser appointed for each district at a salary of \$2000. The appraiser is to have the coöperation of local banks in securing information relative to the applicant for a loan, and the services of state and county officials in passing upon title abstracts. These services are to be rendered without fee. Furthermore, the bonds will have as security the bank's reserve fund. The board, however, has the discretionary power to refund to each borrower, who has made regular payments for at least ten years, the reserve of one half per cent collected on his payments or that portion of it which remains after charging it with its share of expenses and loss. When the reserve fund has accumulated to an amount sufficiently large that it will no longer be needed to insure the solvency of the bank, the legislature is to provide for its repayment to the state. Finally, the bonds are exempt from taxation; and in all cases where the law requires a deposit of securities to be made with the superintendent of insurance or the state treasurer, the bonds are to be available for that purpose "as if they were the bonds of the state of Missouri."

Under the New York law⁴ of 1914 some noteworthy results have already been accomplished.⁵ The Land Bank of the State of New York—an adaptation of the Central Landschaft of Prussia—is now fully organized. Over forty savings and loan associations with total assets of approximately \$20,000,000 have met the organization requirements. The first bond issue of \$250,000, maturing in ten years and bearing an interest rate of 4½ per cent, has also been authorized. A successful effort is being made to sell the first issue of bonds to the large financial institutions. The funds thus derived from the sale of the bonds will be loaned by the land bank to member associations at 5 per cent. Owing to the coöperative structure of these associations the cost of placing the loans will be comparatively small and the farmer's rate of interest is expected to be well below 5 per cent once the system has become firmly established. At present, the one concern of the organizers is to arouse the interest of farmers in the new system so that they will be induced to become members of the local associations.⁶

The reasons for the general activity of the state legislatures in the field of rural credit legislation are not far to seek. With the practical exhaustion of the supply of free land, the farmer who aspires to land ownership is now obliged to depend upon his borrowing power with the various financial institutions rather than upon the generosity of the federal government. And it is generally admitted that our state and national bank systems are prejudicial to his needs. These institutions, developed for the most part to meet the needs of the commercial and industrial classes, are unable as commercial banks to extend to the farmer on the most advantageous terms the kind of credit he requires. At present, about the longest term of loan allowed by commercial banks on farm mortgage security is five years, which is far too short a period for the repayment of a loan out of the product of land. Moreover, the method of repayment is haphazard, the possibility and conditions of renewal uncertain, and the expenses in the way of interest charges, commissions, etc. are much higher than farm

⁴Laws of New York, ch. 369, art. X.

⁵For a critical analysis of the provisions of the law see Herrick and Ingalls, *Rural Credits*, pp. 235-239.

⁶The writer is indebted to Edwin F. Howell, managing director of the land bank, for the facts in regard to the bank's organization as it existed on August 12, 1915.

mortgage security under a specialized and mobile system of land credit would warrant.

Similar objections could be urged against the present method of granting short-term loans to farmers, but current proposals for rural credit reform are concerned primarily with an improvement of the facilities for land-mortgage rather than personal credit. There are several reasons for the concern. In the first place, it is claimed that a reform in the land credit system which reduced the rate of interest on long-term loans would effectively curtail the growth of farm tenancy in this country by making it possible for a young man of small means eventually to become a landowner. In the second place, it is generally agreed that the same institution can not properly deal in both kinds of credit and that therefore the problem of land credit should be dealt with separately. Finally, it is suggested that with lower interest rates on long-term loans the problem of short-term credit would become of less serious consequence because farmers would be able annually to use a larger proportion of their earnings in financing temporary claims.

The conclusion seems to be well established that the defects in the land credit system have contributed materially to the growth of farm tenancy in the United States, especially in the Southern and Middle Western states. From decade to decade the increase in the percentage of tenancy continues, assuming in some sections significant proportions. In many of the agricultural counties in Iowa and Illinois a majority of the farms are already operated by tenants; and in at least eight of the agricultural states⁷ in the South less than one half of the total number of farms under cultivation are operated by their owners. In time, the tenancy problem may be expected to become even more general. This situation is not to be viewed with complacency. While it is true that farm tenancy is, in many cases, the natural and necessary status preliminary to land ownership, the fact remains that the possibility of acquiring land from its earnings in the course of a natural lifetime is gradually becoming more remote. And when the stage has been reached where the younger generation of farmers is unable to look forward to the ownership of land, there will be a division of society into classes and an inequality in oppor-

⁷ Alabama, Arkansas, Georgia, Louisiana, Mississippi, Oklahoma, South Carolina, and Texas. *Thirteenth Census of the United States*, vol. V, pp. 125-126.

tunity entirely opposed to the spirit of American institutions. Moreover, a system of tenant farming is not, from the point of view of agricultural progress, an ideal one. The tenant, unbound by property ties, takes little interest in the development of a wholesome community life. His methods of tillage are wasteful and soil-depleting. The general movement for the betterment of rural credit conditions is, in the last analysis, a direct outgrowth of the conservation movement, to which farm tenancy is stubbornly opposed. Since the federal government has failed to take the initiative in establishing an adequate credit system for the farm tenant, it is only natural that the states should undertake to solve the problem independently.

But the general increase in farm tenancy in the last twenty-five years is not to be attributed so much to the defects in the land credit system as to the fact of rising land values—a problem which current reform measures have failed to consider. Throughout the Middle West, if not the whole country, land is held for speculative purposes. Owing to the rapid rise in the prices of farm products since 1900, there has been a phenomenal increase in the value of land and a growing confidence in the minds of farmers that the ownership of land is equivalent to the certainty of an unearned increment. And this confidence has been shared by other classes. Even merchants, bankers, and private investors have contributed to the speculative spirit—purchasing land with idle funds, deriving whatever income it yielded in the hands of incompetent tenants, and awaiting the natural increase in value. The immediate effect of this speculative activity has been to raise the value of land far above the capitalization of its rent at the current rate of interest. It has placed a premium on tenancy and wasteful farming. Investigations of the Department of Agriculture covering three representative areas in three essentially agricultural states have shown conclusively that the present ratio of farm earnings to expenses is extremely unfavorable to land ownership.⁸

If, then, state activity in the field of rural credit legislation is to become the prevailing fashion, the question arises, What will be the effect of such legislation on the tenancy problem? If any reform measure succeeds in strengthening the borrowing power of *all* farmers, will it necessarily improve the prospect of a farm tenant?

It is undoubtedly true that the adoption of a land credit system

⁸ Bulletin No. 41, United States Department of Agriculture, p. 24, table XVII.

providing for a low rate of interest and a longer term of loans, repayable by amortization, would enable a man of small means eventually to become a landowner. True amortization as a method of repaying the principal literally compels the borrower to save. But it does not follow that farms thus acquired would be farms of profitable size or that the percentage of farm tenancy would decline. After all, there is an intimate relation between the value of land and the current rate of interest. However strained that relation may become, the value of land is certain to rise in response to a reduction in the farmer's rate of interest. Indeed, there is abundant evidence that a lower rate would only add to the present speculative element in farm land investments. Recently, there have come to the attention of the writer a great many cases where prosperous farmers are incurring heavy mortgage indebtedness at fairly high interest rates and acquiring new land, in the belief that direct governmental aid will enable them ultimately to convert their interest charges to lower rates and to realize a speculative profit on the land thus acquired in advance. Manifestly, legislation which *promotes* the spirit of land speculation by promising higher land values tends not only to make it more difficult for a tenant to acquire in the course of his productive years a farm of the most profitable size, but also to encourage concentration in ownership, absentee landlordism, and its concomitant, farm tenancy. In short, the effect of legislation which seeks to improve the prospects of tenants by reducing the rate of interest to all farmers may be to accentuate rather than to mitigate the problem.

There are various ways of attacking the tenancy problem. If, however, a reform in the land credit system is to be the initial step in reducing the percentage of farm tenancy, some measures should be taken to prevent the general rise in land values that would normally result. One of the simplest devices for this purpose is the tax weapon. Either a special tax imposed on land not cultivated by the owner, or a progressive tax on all holdings above a certain minimum value would, if properly administered, have a remedial effect on land speculation and concentration. In New Zealand, where the state makes advances to settlers at a low rate of interest, a graduated tax on land has been employed for a number of years. Although imposed originally with the object of breaking up the large estates,⁹ it has, at the same time, been responsible in

⁹ Le Rossignol and Stewart, *State Socialism in New Zealand*, p. 128.

no small measure for the success of the Liberal government's policy of direct aid to farmers. The ability to borrow from the state at a low rate of interest has been a powerful incentive to the New Zealand farmer to become a landowner; and the imposition of progressive land taxes has prevented a corresponding increase in land values. It is true that speculative tendencies have not been entirely eradicated,¹⁰ but the fact that the small farmer has prospered is significant. On the whole, the plan is suggestive. It is quite improbable, however, that any such measure would be feasible in the United States. So long as the administrative machinery of the several state governments is weak and ineffective in carrying out the ordinary property tax legislation, the administrative difficulties involved in the more complicated program of progressive land taxes would seem to be of such a serious nature as to condemn their use altogether in connection with rural credit measures. Moreover, there is a decided inclination on the part of the American states to abolish the general property tax as a source of state revenue, and for that reason alone the progressive tax plan may be dismissed as impractical and inexpedient.

If any reform measure is to succeed in reducing the percentage of farm tenancy in the United States by reducing the borrower's rate of interest, the lower rate must be accompanied by specific limitations on the borrowing power of present landowners. About the only way in which this can be accomplished without resorting to "class legislation" is by the adoption of a program following out the fundamental principles embodied in the liberal land policy of the federal government. First of all, there should be, in any rational scheme of rural credit reform designed to aid the farm tenant, a careful limitation on the amount of long-term credit that can be extended to any one individual. Some attempts of this kind have already been made in current legislative measures. The Missouri law provides that individual loans shall not be in excess of \$10,000, and that applications for loans under \$5000 shall be given administrative preference. The new Oklahoma law fixes the maximum loan at \$2000. But even this restriction seems liberal. Certainly, any larger grant would only encourage land purchasers to indulge in the same kind of speculative ventures that have characterized farm land investments for a number of years. Furthermore, an effective policy would provide that loans be made only for the purpose of *acquiring* land and on condition

¹⁰ *Ibid.*, 131.

that the land acquired be cultivated by the owner for a definite period of years or until the loan is repaid. These restrictions would virtually, but not technically, prohibit a utilization of the scheme by present landowners and private speculators. A reasonable relation would be maintained between the value of land and its productive capacity. And, with a lower rate of interest, the farm tenant of worthiness and ambition would have better prospects of becoming a landowner.

The establishment of a land credit system suitable to the needs of farm tenants is clearly beyond the province of private initiative. The problem can be dealt with only by direct governmental aid. There is, however, a well-defined field for private enterprise in rural credit reform. When the states have provided for the incorporation and regulation of land credit banks, authorized to make long-term loans on the security of farm lands and to provide capital through the sale of land-mortgage bonds, the long-term credit requirements of landowners can be readily supplied by institutions conducted for profit. It is not to be expected that these institutions will greatly reduce the farmer's rate of interest. An improvement in the method of making loans is, under existing conditions, much more to be desired. But, by giving greater mobility to private capital and eliminating some of the waste in the present land credit system, they can at least give the farmer a rate of interest commensurate with the security he has to offer.

Two such companies have been formed in Wisconsin under the 1913 law. Their bonds have sold at 5 per cent.¹¹ Likewise, the land-mortgage bonds of the Woodruff Trust Company of Joliet, Illinois, organized under the general trust company laws of that state, bear an interest rate of 5 per cent. This company has been in actual operation for the past three years and has achieved no small degree of success. Loans are made to farmers for terms of twenty years, repayable by amortization, at an interest rate of 6 per cent and the expense growing out of renewal commissions is entirely eliminated.¹² In Kansas there is being organized the Kansas Land Credit Trust Company with a capital stock of

¹¹ Hibbard and Robotka, "Farm Credit in Wisconsin," Wisconsin Bulletin 247, p. 30.

¹² George Woodruff, "Rural Credits in Operation," an address delivered before the convention of the Southern Commercial Congress at Muskogee, Oklahoma, April 27, 1915.

\$500,000. It is planned to have the stock widely scattered over the state, to be owned, in fact, by the stockholders in land credit banks. One of these institutions will be established in each county. The local institution will make long-term loans at 6 per cent, turn over the mortgages to the central trust company, and debenture bonds will then be issued against them. Once this system is fully organized it ought to be successful. With a widely scattered body of stockholders, the difficulties heretofore encountered by land-mortgage companies in educating the farmer to a proper understanding of long-term loans and amortization will have been largely overcome. Besides, in providing for an organization extending into every agricultural section of the state, the business of making farm loans can be carried on with a comparatively small margin of expense and the volume of transactions ought to be sufficiently large to assure liberal dividends on the initial capital.

The enactment of laws governing the formation of these companies, so supervised and regulated as to afford a reasonable degree of security to the holders of land-mortgage bonds, would solve the problem of long-term credit for landowners. This seems to be the logical field for state activity. In addition, it would be well to exempt the bonds from taxation, proscribe some of the objectionable features in the foreclosure and exemption laws, and improve the system of land-title registration. This is about all that state legislation should attempt to accomplish. While it is indeed certain that a state could establish a strong centralized bank or adopt a program of state loans that would reduce the farmer's rate of interest below the rate that can be profitably offered by competitive land credit companies, such a course of action is without justification. Not only would it add to the embarrassing problems for which the irregularity in state legislation has been responsible, but also, as has been indicated, it might serve merely to aggravate the tenancy problem. In so far as the reason for rural credit reform is to be found in the increasing percentage of farm tenancy, the larger program of direct aid is one to be instituted by the federal government. And, in the opinion of the writer, it would be as logical for the federal government to grant special aid to the young man desiring to own a farm as it was to adopt the free land policy which made ownership rather than tenancy the characteristic form of land tenure in this country.

GEORGE E. PUTNAM.

University of Kansas.